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SUBJECT: Hang Seng Recovers from Flu but Trade Volumes Still In ICU

¶1. SUMMARY: Flu fears pushed down the Hang Seng early in the week, but the Index had fully recovered by April 30. The Hong Kong Monetary Authority will include flu-inspired scenarios in its next round of bank stress testing. Hong Kong's ExCo approved plans to issue up to HKD 100 billion in government debt over the next five to ten years, but there is still no clear indication of how the money will be used. Pending Legco approval, the government bonds could be issued before the end of 2009. Hong Kong trade fell more than 20 percent again in March. The Hong Kong Airport Authority will offer a 10 percent discount on landing and parking fees to help airlines weather the storm. End summary.

Hang Seng Index Rebounds After Flu-inspired Sell-off

¶2. The announcement April 26 that a new and deadly flu was quickly spreading from Mexico to the U.S., Canada and other regions reminded many investors of Hong Kong's calamitous experience with SARS in ¶2003. Local investors dumped their shares and pushed the Hang Seng Index down by 4.6 percent or 703.74 points on April 27 and 28. The Hong Kong Government's quick response to the potential threat appears to have comforted the public and market sentiment improved on April 29 and 30, with the Hang Seng Index gaining 2.76 percent and 3.8 percent respectively, fully recovering its losses from the previous two days. On April 30, the Hang Seng Index closed at 15,520.99, up 1.7 percent or 262.14 points from Friday, April 24. Daily trading volume increased to HKD 71 billion, up HKD 19 billion from the previous Friday. The Hong Kong Stock Exchange will be closed May 1.

¶3. On April 30, Hong Kong Monetary Authority (HKMA) Chief Executive Joseph Yam told the press that the HKMA will conduct stress testing for local banks, including assessing the impact of swine flu on the banking system. The news didn't seem to impact banking stocks, with both Hong Kong and mainland Chinese banks rebounding strongly. Local giants HSBC, ICBC, China Construction Bank and Bank of China all gained 2.5 to 3.5 percent. HIBOR quoted by the Hang Seng Bank were 0.05 percent for overnight and one-week, 0.16 percent for one-month, 0.76 percent for three-month and 1.06 percent for six-month loans.

Bonds... Hong Kong Government Bonds

¶4. On April 28 the Hong Kong Executive Council approved the issue HKD 100 billion worth of Hong Kong Government bonds over the next five to ten years aimed at both retail and institutional investors. With the approval of Legco, the government is expected to issue HKD 10 to 20 billion (USD 1.3 to 2.6 billion) in the first tranche of bonds before the end of the year. Secretary for Financial Services and the Treasury K.C. Chan told the press that the revenues would be credited to a new "Bond Fund" managed by the Hong Kong Monetary Authority.

¶5. Secretary Chan noted that the primary objective of the government bonds is "to increase the breath, depth and liquidity of the local bond market, so that it can complement the banking and equity markets as an effective channel of financial intermediation".

According to Chan, the initial tranche will include maturities of 2 to 10 years, but he did not comment on yields. Market observers predicted the Hong Kong government would list the new bond issue on the Hong Kong Stock Exchange. With over US$50 billion in fiscal reserves, there is no current budgetary need for the government to borrow money. HKMA officials also do not know precisely how the money will be handled but expect it will be managed as a part of the HKMA Investment Fund.

¶6. This will not be the first time the Hong Kong Government has issued sovereign debt. Shortly after returning to Chinese control in 1997, Hong Kong issued HKD 24 billion (USD 3.2 billion) to fund capital works projects. Two additional government bond offerings in 2004 were met with strong demand and over-subscribed.

Hong Kong's March Trade Still Down

¶7. Hong Kong's total exports of goods in March fell 21.2 percent from a year ago, with exports to the U.S. down 23.3 percent. Total imports also dropped by 22.7 percent. Falling cargo and passenger volumes have led the Hong Kong Airport Authority to take measures to alleviate the burdens of the airlines. Airlines operating at the Hong Kong International Airport are being offered a 10 percent reduction in both landing and parking charges till the end of 2009, amounting to the revenue reduction of about HKD 200 million to the Airport Authority.

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